

Arizona State Lottery Commission

JLBC: Tom Mikesell
 OSPB: Tracie Andreasson

Subcommittee: Education

DESCRIPTION	FY 2002	FY 2003	FY 2004		FY 2005	
	ACTUAL	ESTIMATE	OSPB	JLBC	OSPB	JLBC
PROGRAM BUDGET						
Sales and Support	6,821,600	7,106,300	7,152,400	7,149,300	7,159,700	7,084,800
Advertising SLI	6,128,000	7,554,600	6,599,100	7,697,700	7,079,300	7,897,500
Compulsive Gambling Treatment and Information SLI	455,900	500,000	500,000	500,000	500,000	500,000
Instant Tickets SLI	3,582,400	4,634,500	4,343,500	4,727,500	4,651,500	4,975,500
On-Line Vendors Fees SLI	7,543,500	6,502,000	5,254,100	6,616,800	5,591,100	6,586,900
Retailer Commissions SLI	19,763,200	18,746,600	16,257,900	19,101,700	17,370,600	19,597,500
Sales Incentive Program SLI	21,800	50,000	50,000	50,000	50,000	50,000
Telecommunications SLI	2,596,900	2,814,400	2,814,400	2,814,400	2,814,400	2,814,400
AGENCY TOTAL	46,913,300	47,908,400	45,209,300	48,657,400	45,216,600	49,506,600

OPERATING BUDGET

<i>Full Time Equivalent Positions</i>	123.0	123.0	123.0	123.0	123.0	123.0
Personal Services	4,017,700	4,308,500	4,308,500	4,308,500	4,308,500	4,308,500
Employee Related Expenditures	858,100	1,018,500	1,030,200	1,029,600	1,030,200	1,029,600
Professional and Outside Services	310,000	341,600	344,100	341,600	346,800	341,600
Travel - In State	218,300	246,400	246,400	246,400	246,400	246,400
Travel - Out of State	8,600	16,700	16,700	16,700	16,700	16,700
Other Operating Expenditures	1,085,600	1,110,100	1,142,000	1,142,000	1,142,000	1,142,000
Equipment	323,300	64,500	64,500	64,500	69,100	0
OPERATING SUBTOTAL	6,821,600	7,106,300	7,152,400	7,149,300	7,159,700	7,084,800
Special Line Items (SLI)	40,091,700	40,802,100	38,056,900	41,508,100	38,056,900	42,421,800
AGENCY TOTAL	46,913,300	47,908,400	45,209,300	48,657,400	45,216,600	49,506,600

FUND SOURCES

Other Appropriated Funds

State Lottery Fund	46,913,300	47,908,400	45,209,300	48,657,400	45,216,600	49,506,600
SUBTOTAL - Other Appropriated Funds	46,913,300	47,908,400	45,209,300	48,657,400	45,216,600	49,506,600
SUBTOTAL - Appropriated Funds	46,913,300	47,908,400	45,209,300	48,657,400	45,216,600	49,506,600
Other Non-Appropriated Funds	162,118,200	153,809,800	NA	161,573,900	NA	167,375,600
TOTAL - ALL SOURCES	209,031,500	201,718,200	NA	210,231,300	NA	216,882,200

CHANGE IN FUNDING SUMMARY

	FY 2003 to FY 2004 JLBC		FY 2003 to FY 2005 JLBC		Biennial
	\$ Change	% Change	\$ Change	% Change	\$ Change
Other Appropriated Funds	749,000	1.6%	1,598,200	3.3%	2,347,200

AGENCY DESCRIPTION — The Arizona Lottery is responsible for administering sanctioned games of chance. Arizona-specific games include instant tickets, the Pick, Pick 3 and Fantasy 5 on-line games. Arizona also participates in the multi-state Powerball on-line game.

PERFORMANCE MEASURES	FY 2002 Appropriation	FY 2002 Actual	FY 2003 Appropriation	FY 2004 Recommend.
• Amount of estimated on-line sales (\$ in millions)	112.9	151.4	105.4	132.6
• Amount of estimated instant ticket sales (\$ in millions)	136.9	143.4	140.1	152.5
• Average amount of sales per Instant Ticket Vending Machine (ITVM) (in \$)	98,754	86,900	107,477	--
• % of active retailer accounts in good standing	99.8	99.5	99.8	99.8
• % of agency staff turnover	13.5	11.4	13.5	11.4
• Administration as a % of total cost	8.1	NA	8.1	8.3
• Customer satisfaction rating for retailers (Scale 1-8)	6.0	NA	6.0	6.1
• % of Lottery ticket sales distributed to state beneficiaries (NEW)		27.95		27.95

Comments: The agency did not submit information for any measure labeled as "NA." The average sales per ITVM was below the estimate for FY 2002 due to the introduction of 100 new ITVMs which had a lower sales per machine than the base machines used to calculate the estimated average.

RECOMMENDED CHANGES FROM FY 2003

		<u>FY 2004</u>	<u>FY 2005</u>
Standard Changes	OF	\$43,000	\$43,000

Computer Upgrades	OF	0	(64,500)
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The JLBC recommends a State Lottery Fund decrease in FY 2005 for the elimination of one-time computer replacement expenses. In FY 2002, the Lottery commenced a 3-year computer replacement schedule as approved by the Government Information Technology Agency. The last year of this plan is FY 2004.

Sales Related Adjustments

The recommended funding for the following Special Line Items is based on a percentage of ticket sales. Therefore, the funding amounts listed are only estimates and are based on the JLBC Staff forecast of ticket sales (*see Other Issues for Legislative Consideration*). For FY 2004, the JLBC Staff forecasts instant ticket sales of \$152,500,000 and on-line ticket sales of \$132,600,000, for a total of \$285,100,000. For FY 2005, the JLBC Staff forecasts instant ticket sales of \$160,500,000 and on-line ticket sales of \$132,000,000 for a total of \$292,500,000.

Instant Tickets	OF	93,000	341,000
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The JLBC recommends for FY 2004 and FY 2005 that 3.1% of instant ticket sales be appropriated for instant ticket printing. The recommended rate is consistent with the Lottery's anticipated expenditures for instant ticket printing and product management system costs.

Advertising	OF	143,100	342,900
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Statute requires advertising expenditures to be less than 4% of total ticket sales. In FY 2004 and FY 2005, the JLBC recommends continuation of the FY 2003 rate of 2.7% of total ticket sales for Advertising.

On-Line Vendor Fees	OF	114,800	84,900
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The JLBC recommends for FY 2004 and FY 2005 that an amount equal to a percent of on-line game sales as determined by contract be appropriated for On-Line Vendor Fees. The current contract percentage is 4.99%. The FY 2005 increase is lower due to lower level of on-line ticket sales.

Retailer Commissions	OF	355,100	850,900
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The JLBC estimates that the retailer compensation rate will be 6.7% of total ticket sales in both FY 2004 and FY 2005. Statute allocates 6.5% of total ticket sales to retailers as compensation for selling tickets. In addition, statute allows for up to 0.5% more to be allocated in FY 2004 and FY 2005 if retailers meet certain sales and marketing goals. The JLBC estimates that 40% of Lottery retailers will meet the Lottery's specified goal of sales 5% greater than total Lottery sales growth. Therefore, the displayed compensation percentage is derived by adding 0.02% to the base compensation of 6.5%. This added amount represents the marginal increase to only the retailers that meet the Lottery's sales goal.

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JLBC RECOMMENDED FORMAT — Lump Sum by Agency with Special Line Items

JLBC RECOMMENDED FOOTNOTES

Standard Footnotes

An amount equal to 3.1% of actual instant ticket sales is appropriated for the printing of instant tickets or for contractual obligations concerning instant ticket distribution. This amount is currently estimated to be \$4,727,500 in FY 2004 and \$4,975,500 in FY 2005.

An amount equal to 2.7% of gross lottery game sales, but no more than \$11,000,000, is appropriated for Advertising in accordance with A.R.S. § 5-505, that states that not

more than 4% of the annual gross revenues shall be expended for Advertising. This amount is currently estimated to be \$7,697,700 in FY 2004 and \$7,897,500 in FY 2005.

An amount equal to a percentage of actual on-line game sales as determined by contract is appropriated for payment of on-line vendor fees. This amount is currently estimated to be \$6,616,800 in FY 2004 and \$6,586,900 in FY 2005 or 4.99% of actual on-line ticket sales.

An amount equal to 6.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. In accordance with Laws 1997, Chapter 214, an additional amount of not to exceed 0.5% of gross lottery game sales is appropriated for payment of sales commissions to ticket retailers. The combined amount is currently estimated to be 6.7% of total ticket sales, or \$19,101,700 in FY 2004 and \$19,597,500 in FY 2005.

Of the amount appropriated for Compulsive Gambling Treatment and Information, 50% shall be used to contract for a statewide toll free crisis hotline to promote public education and awareness about compulsive gambling problems and to provide public information on gambling addiction. The remaining 50% of the appropriated amount shall be used to contract for the treatment of individuals who are compulsive gamblers.

JLBC RECOMMENDED STATUTORY CHANGES

Powerball Profit Distribution

The JLBC recommends requiring the Arizona Lottery to return 31.6% of Powerball sales in FY 2004 and FY 2005 to the General Fund. Statute currently only requires the Lottery to return 29%. The FY 2002 and FY 2003 rate is 31.6% as provided in Laws 2001, Chapter 238. The recommended rate maintains the return at this amount and ensures that the General Fund receives an additional \$2,236,000 in FY 2004 and an additional \$2,314,000 in FY 2005 compared to the distribution required in statute. The Lottery revenue distribution table includes this return from Powerball in both FY 2004 and FY 2005. (See *“Other Issues for Legislative Consideration – Lottery Forecast”* for additional information.)

OTHER ISSUES FOR LEGISLATIVE CONSIDERATION

Lottery Forecast

The JLBC Staff forecasts a decrease in overall Lottery sales for FY 2003, followed by increases in FY 2004 and FY 2005. For FY 2003, total Lottery sales are forecast to be \$279,800,000. For FY 2004 and FY 2005, the JLBC Staff forecasts Lottery sales of \$285,100,000 and \$292,500,000, respectively.

The largest contributor to the FY 2003 forecasted decrease is the multi-state Powerball game. In FY 2002, this game hit its highest historical sales level due to a large jackpot in

August of 2001. Due to the inability to predict a continuance of this record-setting performance, the forecast calls for a decrease in FY 2003 followed by flat growth in FY 2004 and FY 2005.

Of the mix of state-only games that the Lottery implements, instant tickets have been the most successful, posting a 6.5% average annual increase over the last 5 years. The JLBC forecasts continued growth in instant tickets sales over the next 3 years fueled by growth in the retailer base and population.

The recent growth in instant ticket sales, however, has been tempered by a (6.0)% average annual decrease in state-only on-line game sales during the same period. Additions of new games, such as Pick 3 introduced in FY 1998, have had minimal impact on state profit, and may merely be siphoning sales from existing games. Also, the restructuring of the Fantasy 5 drawing schedule in FY 2000 may have temporarily reversed the declining collections from that game, however, recent collections demonstrate a reversion to the previous downward trend. The JLBC forecasts a continuation of the downward trend in state-only on-line sales, as players shift to the instant gratification offered by instant tickets and the potential of large jackpots offered by Powerball.

One potential risk to the forecast is the potential impact on Lottery sales from the expansion of Native American Gaming. In the November 2002 General Election voters approved Proposition 204, which provides for additional slot machines and table games such as blackjack in Native American casinos. It is possible that current Lottery players will substitute casino gaming for playing the Lottery, however, the extent of any substitution effect cannot be measured.

The JLBC Staff forecast of Lottery profits for FY 2004 and FY 2005 applies the FY 2002 percent return to the state for each individual game. In FY 2002, the Lottery returned a total of 28% of all tickets sold.

Forecast of Lottery Revenue Distribution		
	FY 2004	FY 2005
Sales:		
Instant Sales	\$152,500,000	\$160,500,000
On-Line Sales	132,600,000	132,000,000
Total Sales	\$285,100,000	\$292,500,000
Less:		
Operating Budget	\$48,657,400	\$49,506,600
Prizes ^{1/}	161,573,900	167,375,600
Net Profit ^{2/}	\$74,868,700	\$75,617,800
Profit Transfers:		
LTAF	\$23,000,000	\$23,000,000
CAF	7,650,000	7,650,000
Heritage	16,998,500	17,747,600
Clean Air	0	0
Econ. Development	2,220,200	2,220,200
Mass Transit	0	0
Health & Welfare Programs	0	0
General Fund	25,000,000	25,000,000
Total Transfer	<u>\$74,868,700</u>	<u>\$75,617,800</u>
^{1/} Prizes are estimated by subtracting net profit and operating budget expenditures from total Lottery sales. ^{2/} To derive the profit transfer amounts, we applied the actual FY 2002 rate of return for each game to the current forecast.		

SUMMARY OF FUNDS	FY 2002 Actual	FY 2003 Estimate
State Lottery (LOA2122/A.R.S. § 5-521)	Partially Appropriated	
Source of Revenue: Sales of lottery tickets, retailer license fees and interest earnings.		
Purpose of Fund: A portion of the fund is appropriated to pay for all costs of the Arizona State Lottery Commission. In addition, Laws 2001, Chapter 4, 2 nd Special Session transfers \$2,498,000 in FY 2002 from the State Lottery Fund to the General Fund and Laws 2002, Chapter 327 transfers \$2,455,000 from the State Lottery Fund to the General Fund in FY 2003. After all expenses are paid including the prize monies displayed below in the Non-Appropriated Funds Expended line, Lottery profits are distributed to the Local Transportation Assistance Fund, the County Assistance Fund, the Heritage Fund, the Arizona Clean Air Fund, the Economic Development Commission, various health and welfare programs, the General Fund, and the Local Transportation Assistance Fund-Mass Transit, revenues permitting.		
Appropriated Funds Expended - Capital	27,400	38,300
Appropriated Funds Expended - Operating	47,630,200	47,908,400
Appropriated Funds Expended - Profit Distributions	84,900,200	75,588,500
Non-Appropriated Funds Expended	162,118,200	153,809,800
Funds Transferred to General Fund	2,498,000	2,455,000
Year-End Fund Balance	0	0

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